

## DEPARTMENT OF STATE REVENUE

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### LETTER OF FINDINGS NUMBER: 96-0133 ST

#### Sales and Use Tax — Production Machinery

#### Sales and Use Tax — Exemptions

#### Tax Administration — Interest and Penalty

#### For Tax Periods: 1992 Through 1994

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### ISSUES

#### I. Sales and Use Tax — Production Machinery

**Authority:** IC 6-2.5-3; 45 IAC 2.2-5-8; *General Motors v. Department of State Revenue*, 578 N.E.2d.399 (Ind. Tax 1991); *Indiana Department of Revenue v. Cave Stone, Inc.*, 457 N.E.2d. 520 (1983)

Taxpayer protests the assessment of use tax on production machinery claimed by taxpayer to be essential and integral to the production process.

#### II. Sales and Use Tax — Exemptions

**Authority:** IC 6-2.2-5-3; IC 6-2.5-5-4; IC 6-2.5-5-30; 45 IAC 2.2-3-8; 45 IAC 2.2-3-9; 45 IAC 2.2-5-8; 45 IAC 2.2-5-12; 45 IAC 2.2-5-70; 326 IAC 5

Taxpayer protests the assessment of use tax on items claimed by the taxpayer to be essential and integral to the production process.

#### III. Tax Administration — Interest and Penalty

**Authority:** IC 6-8.1-10-1; IC 6-8.1-10-2.1; 45 IAC 15-11-2; 45 IAC 2.2-3-20

Taxpayer protests the imposition of interest and the ten percent (10%) negligence penalty.

### STATEMENT OF FACTS

Taxpayer, an industrial processor, is a Delaware corporation that maintains corporate headquarters in Pennsylvania. As an on-site contractor, taxpayer operates an industrial scrap metal processing facility for a steel maker at an Indiana location. Taxpayer, the subject of an Indiana Sales and Use Tax audit for the years 1992 through 1994, was assessed use tax on certain machinery, tools, equipment, parts, and consumables. Taxpayer argues that the assessed items were "directly used in the direct production, manufacture, fabrication, assembly, processing, refining, or finishing of tangible personal property" and therefore, should be exempt from Indiana sales and use tax.

According to taxpayer, its production process begins at the point in which incoming scrap is weighed on off-road scales within taxpayer's facilities (yard). Two tests are performed concurrently with weighing so that taxpayer can properly sort, segregate, and grade incoming materials. An initial visual inspection is conducted to verify the scrap's density and purity. Scrap is also scanned for the presence of any radioactive material. A laboratory inspection for metallurgical content may later be performed.

The scrap may also be blended or re-graded into lots and piles to create a more uniform consistency. Graded scrap is then moved either to separate stockpiles in the yard, or to the baling, shearing, and burning sites for further processing. The baling machine compresses and bales loose scrap material into blocks of uniform density. In order to meet buyer's requirements, a shearing machine may be used to cut large pieces of scrap into smaller pieces. Hand-held acetylene torches are also used in the cutting process. Scrap is then transported to either segregated stockpiles within the yard, or directly to trucks and railroad cars for shipment. But prior to sending the processed scrap to the buyer, the trucks and railroad cars containing the processed scrap metal are once again weighed and visually inspected.

#### I. Sales and Use Tax – Production Machinery

### DISCUSSION

Taxpayer and the Department disagree on the scope of taxpayer's production process. Taxpayer argues that its production process begins and ends with the weighing of the scrap metal. Under its definition of the production process, taxpayer feels justified in claiming use tax exemptions - per IC 6-2.5-3-(b) and 45 IAC 2.2-5-8(h)(2) - on its purchase of off-road weigh scales, pedestal and mobile cranes, and other transportation vehicles and equipment. The Department takes a narrower view. The Department has exempted only those operations that directly affect the product - such as cutting, shearing, baling, torching, and burning.

Denying the exemptions, the auditor concluded that the off-road weigh scales, pedestal and mobile cranes, and other transportation vehicles and equipment were used only in pre-production and post-production activities and consequently, were taxable.

In Indiana, an excise tax (sales tax) is imposed on retail transactions. A complementary excise tax (use tax) is imposed on tangible personal property that is stored, used, or consumed in this state. Several exemptions from these taxes are available. Taxpayer, in this instance, invokes one of the industrial exemptions.

Referred to as the equipment exemption, IC 6-2.5-5-3(b) reads:

Transactions involving manufacturing machinery, tools and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it for *direct* use in the *direct* production, manufacture, fabrication, assembly, extraction, processing, refining, or finishing of other tangible personal property. (Emphasis added.)

In *Indiana Department of State Revenue v. Cave Stone, Inc.* (1983), 457 N.E. 2d 520, the Supreme Court of Indiana interpreted the “double direct” language of IC 6-2.5-5-3(b) to require that the manufacturing equipment used be an essential and integral part of the production process.

In arriving at its conclusion, the Court in *Cave Stone* rejected a narrow construction of the industrial exemption statute. Instead of focusing on whether a particular activity had a transformational effect on the product, “the [C]ourt held [that] the ... equipment at issue was both essential to transforming crude stone into a marketable product and integral to ‘the ongoing process of transformation.’” *General Motors v. Department of State Revenue*, 578 N.E.2d 399, 401 (Ind.Tax 1991) interpreting *Cave Stone*.

To supplement its “essential and integral” language, the Court in *Cave Stone* also adopted a broad definition of “production.”

In an economic sense, production includes all activity directed to increasing the number of scarce economic goods. It is not simply the manual, physical labor involved in changing the form or utility of a tangible article. *Cave Stone* at 524.

The Court applied this perspective in outlining the scope of Cave Stone, Inc.’s - an operator of stone quarries - production process:

The [exemption] statute *circumscribes all of the operations or processes by which the finished product is derived*. Thus, we find that the production or processing of the stone begins at the time of the initial stripping, drilling, and blasting at the quarry and ends at the time the stone is stockpiled. The production process is continuous and indivisible. *Id.* at 524. (Emphasis added.)

Regulation 45 IAC 2.2-5-8(c) summarizes the required test:

The state gross retail tax does not apply to purchases of manufacturing machinery, tools, and equipment to be directly used by the purchaser in the production process provided that such machinery, tools, and equipment are directly used in the production process; i.e., they have an immediate effect on the article being produced. *Property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process which produces tangible personal property*. (Emphasis added).

Exemption from taxation, therefore, depends on: (1) the scope of taxpayer’s production process, and (2) whether the equipment at issue is used in an activity that is an “essential and integral” part of that process.

### **Scope of the Production Process**

Taxpayer describes its production process as one that “transforms scrap metals into prepared grades of iron and steel ... for use in the foundries, mills and smelters of [its] customers.” Consequently, taxpayer’s processed scrap metal must meet particularized customer specifications and industry standards. Most of taxpayer’s products – scrap bundles, scrap shredded, scrap turnings, copper scrap, scrap heavy melting – must meet size, density, content, and metallurgical requirements. Taxpayer is also required “to provide certification with all shipments that the product meets specifications.”

Taxpayer has emphasized that its production process is structured to ensure customer specifications and industry standards are met. Procedures are in place to eliminate non-ferrous metals and impurities from incoming scrap. Inspection and testing are required to identify, select, sort, and properly grade incoming scrap metal. Blending and re-grading are necessary to meet customer’s content requirements. The physical properties of the scrap metal are further changed through the baling, shearing, torching, and cutting operations. Taxpayer maintains the integrity of its product by placing the graded scrap in segregated stockpiles.

Given these documented requirements that taxpayer must meet, the Department agrees with taxpayer that many of the aforementioned activities constitute a part of taxpayer’s integrated production process. Once the incoming scrap is unloaded, the sorting and segregating of scrap, along with the bundling, shearing, and torching processes, are a part of taxpayer’s integrated production process. However, the weighing and unloading of incoming materials are excluded.

Taxpayer additionally suggests that “[t]he processing of scrap metal is not completed until it is in a form deliverable to the consumer (i.e., contained in freight bins) due to the inherent nature of the material.” Taxpayer’s argument recognizes that packaging activities are included in integrated production processes, but storage containers

for finished goods are not. See 45 IAC 2.2-5-8(e)(2). The placing of outgoing scrap in freight bins is not packaging, however, it is a function of shipping.

Taxpayer's integrated production process ends at the point in which the processed scrap is finished for actual sale in the marketplace – i.e., in the form of the most marketable product. See *General Motors* at 402. In this instance, the most marketable product emerges from the baling, shredding, and torching processes. Subsequent activity is post-production.

#### **Off-Road Weigh Scales**

Taxpayer argues that since its integrated production process should begin and end with the *weighing* of the scrap metal on an automated off-road vehicle scale, the off-road scale should be exempt from tax.

In support of its position, taxpayer directs the Department to regulation 45 IAC 2.2-5-8(c) Ex. (2)(G):

(2) The following types of equipment constitute essential and integral parts of the integrated production process and are, therefore, exempt. The fact that such equipment may not touch the work-in-process or, by itself, cause a change in the product, is not determinative.

(G) An automated scale process which measures quantities of raw aluminum *for use in the next production step* of the casting process in the foundry. (Emphasis added.)

The auditor has characterized the weighing of incoming scrap metal as part of taxpayer's pre-production process – a sorting and separating operation used to get the scrap to the proper production process, i.e., shearing, baling, or torching. Weighing, under this characterization, is primarily for inventory control purposes.

Pre-production and post-production activities are defined as those activities that are not directly used in the production process. 45 IAC 2.2-5-8(d) states:

“Direct use in the production process” begins at the point of the first operation or activity constituting part of the integrated production process and ends at the point that the production has altered the item to its completed form, including packaging, if required.

The weighing of incoming scrap is not part of taxpayer's integrated production process. Nothing in taxpayer's description of its production process indicates that other production activities are dependent on the weighing of incoming materials. While incoming materials may be rejected at this point, the weighing of incoming materials is primarily a function of inventory, accounts payable, and accounts receivable, rather than of production.

For similar reasons, the weighing of outgoing materials is not a part of taxpayer's integrated production process. Weighing, in this instance, is primarily a function of inventory, accounts payable, accounts receivable, and shipping. Again, these are not production activities.

Taxpayer's situation is not analogous to the example of the automated weigh scale used to measure quantities of raw aluminum. See 45 IAC 2.2-5-8(c) Ex.(2)(G). That example assumed taxpayer's integrated production process had already begun. The issue addressed there was whether the weighing of certain raw materials was an “essential and integral” part of taxpayer's ongoing integrated process. Here, taxpayer is attempting to show that which the example assumed.

#### **FINDING**

Taxpayer's protest is denied. The Department finds that the weighing of incoming and outgoing scrap is not a part of taxpayer's integrated production process. Therefore, the off-road scales, and those items associated with the weighing activities, are not exempt from sales and use tax.

#### **Pedestal Crane**

Taxpayer protests the Department's proposed assessment of use tax on its purchase and use of a pedestal crane.

Taxpayer uses its pedestal crane to unload, sort, and stack its scrap metal according to type. The pedestal crane is also used to “[convey] selected scrap to the baling, shearing, and burning processes.” Taxpayer contends these activities are essential and integral to the production process and, therefore, the pedestal cranes should be exempt from Indiana sales and use tax.

The auditor characterizes taxpayer's use of the pedestal crane as exclusively for pre-production and post-production activities.

The Department concludes that given customer's content requirements, the sorting, separating, and stacking of scrap metal are “essential and integral” activities of taxpayer's integrated production process. They represent activities necessary to identify, segregate, and transport the proper type and mix of materials to the next production step – i.e., baling, shearing, and torching. However, for those same reasons, the unloading of incoming scrap and loading of outgoing scrap are not exempt activities.

#### **FINDING**

Taxpayer's protest is partially sustained. To the extent that the pedestal crane is used to sort, separate, and stack the scrap metal located in the yard, or is used to transport scrap metal to baling, shearing, and torching

operations, the pedestal crane is exempt from sales and use tax.

#### **Mobile Cranes and Transportation Equipment**

Taxpayer protests the Department's proposed assessment of use tax on the purchase of mobile cranes and other transportation equipment.

Taxpayer uses mobile cranes, forklifts, trucks, railroad cars and a locomotive engine to transport scrap within the facility to different stages of processing. Taxpayer believes that the equipment exemption should apply to all its transportation equipment "without which the finished product could not be produced." (Taxpayer notes that none of the transportation equipment is licensed for highway use.)

The auditor has characterized taxpayer's use of mobile cranes, forklifts, trucks, railroad cars and a locomotive as exclusively for pre-production and post-production activities.

Regulation 45 IAC 2.2-5-8(f)(3) states:

Transportation equipment used to transport work-in-progress or semi-finished materials to or from storage is not subject to tax if the transportation is within the production process.

The Department finds that the transporting of scrap – after its initial unloading - to the shearing, baling, and torching processes and to the various segregated stockpiles is an integral part of taxpayer's integrated production process.

The taxpayer's protest is sustained to the extent that its transportation equipment is used to transport work-in-progress to the baling, shearing, and torching operations and to the various segregated scrap stockpiles.

#### **FINDING**

Subject to verification, taxpayer's protest is sustained to the extent that the mobile cranes and transportation equipment are used in production activities.

## **II. Sales and Use Tax — Exemptions**

### **Replacement Parts for Manufacturing Equipment**

Taxpayer protests the assessment of sales and use tax on an assortment of replacement parts.

Taxpayer reasons that since the replacement parts were purchased for exempt equipment and machinery, the replacement parts should also be exempt.

According to 45 IAC 2.2-5-8(h)(2):

Replacement parts, used to replace worn, broken, inoperative, or missing parts or accessories on exempt machinery and equipment, are exempt from tax.

The Department concludes that to the extent the replacement parts are for equipment and machinery that are exempt from sales and use tax, the replacement parts are also exempt.

#### **FINDING**

Taxpayer's protest is sustained to the extent that the replacement parts are for exempt equipment and machinery.

### **Fuel, Lubricant and Solvents Consumed Directly in the Production Process**

Taxpayer protests the assessed tax on hydraulic fluid, diesel fuel, and gasoline.

Taxpayer has made significant purchases of hydraulic fluid (oil), diesel fuel, and gasoline. Taxpayer argues that these products are directly consumed by equipment that is used in the production process. Hydraulic fluid is consumed in the operation of engines in the baler and shearer. The pedestal and mobile cranes and forklifts also consume hydraulic fluid. Diesel fuel is used to fuel all the heavy equipment. Gasoline powers the transportation vehicles that are used in the yard.

Regulation 45 IAC 2.2-5-12(a) reads:

The state gross retail tax shall not apply to sales of any tangible personal property consumed in direct production by the purchaser in the business of producing tangible personal property by manufacturing, processing, refining, or mining.

Since the hydraulic fluid, lubricants, and gasoline are consumed by equipment that is exempt, or partially exempt, the Department believes that the consumables should also be exempt from sales and use tax.

#### **FINDING**

Taxpayer's protest is sustained to the extent that the hydraulic fuels, lubricants, and solvents are consumed by exempt equipment and machinery used in taxpayer's production process.

### **Gas Lines**

Taxpayer protests the assessment of sales and use tax on natural gas and oxygen lines.

Taxpayer has installed underground lines that transport natural gas and oxygen from underground storage to an above ground spigot. The hand-held torches, which are used in the burning process, are then connected to this spigot. Taxpayer has indicated that these gas lines are used exclusively for delivering oxygen and natural gas (acetylene) to its exempt equipment.

Taxpayer argues that according to 45 IAC 2.2-5-8(c)(2), purchases of equipment used to deliver fuel that is used to power exempt tools and machinery is also exempt from retail sales and use tax. Specifically, the gas lines are used to transport an exempt consumable - gas - to exempt equipment. Taxpayer reasons that such use should qualify for an exemption as equipment that is "essential and integral" to taxpayer's integrated production process.

The gas lines, however, are simply a means of transporting the gases from storage to their step in the production process. According to 45 IAC 2.2-5-8(f)(1), "[t]angible personal property used for moving raw materials to the plant prior to their entrance into the production process is taxable."

#### **FINDING**

The Department finds that the gas lines, running from storage to the above ground spigots, are used exclusively in the pre-production phase - and such use is taxable. Taxpayer's protest is denied.

#### **Construction Contract for Maintenance Building**

Taxpayer protests the assessment of use tax on materials and labor used to construct an on-site building.

Taxpayer contracted to construct a multipurpose building on its premises. The building contains a service bay to install parts in exempt equipment, a machine shop to fabricate parts, a locomotive service pit, and a locker room with shower facilities for production workers.

Taxpayer explains that "a substantial portion (seventy-five percent) of the building is dedicated to the fabrication and installation of replacement parts for the various equipment used within the yard." Taxpayer, relying on 45 IAC 2.2-3-8, reasons that a similar percentage of the cost of the tangible personal property incorporated into the machine shop building should also be exempt from taxation.

Regulation 45 IAC 2.2-3-8 states:

(a) In general, all sales of tangible personal property are taxable, and all sales of real property are not taxable. The conversion of tangible personal property into realty does not relieve the taxpayer from a liability for any owing and unpaid state gross retail tax or use tax with respect to such tangible personal property.

(b) All construction material purchased by a contractor is taxable either at the time of purchase, or if purchased exempt (or otherwise acquired exempt) upon disposition *unless the ultimate recipient could have purchased it exempt.* (Emphasis added.)

The above exception to the general rule does not apply because taxpayer could not have purchased the materials exempt. Although the materials are used to construct a building which taxpayer uses to craft replacement parts for some of its exempt machinery, such use does not qualify the construction materials for exemption under IC 6-2.2-5-3(b).

Regulation 45 IAC 2.2-3-9 states in part:

(d) Disposition subject to the state gross retail tax. A contractor-retail merchant has the responsibility to collect the state gross retail tax and to remit such tax to the Department of Revenue whenever he disposes of any construction material in the following manner:

(1) Time and material contract. He [contractor-retail merchant] converts the construction material into realty on land he does not own and states separately the cost for the construction material and the cost for the labor and other charges (only the gross proceeds from the sale of the construction materials are subject to tax).

Absent contractual language indicating otherwise, it appears that taxpayer and contractor – as evidenced by the three submitted invoices - entered into a time and material contract. As no evidence has been presented to suggest taxpayer paid any sales tax, the tax was correctly assessed on the construction materials. Labor, however, is exempt from sales and use tax.

#### **FINDING**

Taxpayer's protest is sustained to the extent use tax was assessed on construction labor. Taxpayer's protest is denied to the extent that use tax was assessed on construction materials.

#### **Tools for the Machine Shop**

Taxpayer protests the assessment of use tax on tools and equipment used at taxpayer's on-site machine shop to fabricate and install replacement parts for exempt machinery and equipment.

Taxpayer relies on IC 6-2.5-5-4 which states:

Transactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it for his direct use in the direct production of the machinery, tools, or equipment described in section 2 or 3 of this chapter. (Chapter 3 deals with manufacturing machinery, tools and equipment).

Tools and equipment used *to fabricate* replacement parts for exempt machinery are exempt under IC 6-2.5-5-4. However, tools and equipment used *to install* replacement parts are not exempt from sales and use tax.

45 IAC 2.2-5-8(h)(1) addresses the issue of maintenance equipment:

Machinery, tools, and equipment used in the normal repair and maintenance of machinery used in the production process which are predominantly used to maintain production machinery are subject to tax.

Because the installation of replacement parts is considered to be a “normal repair and maintenance” function, the tools and equipment used to install replacement parts are not exempt from sales and use tax.

#### **FINDING**

Taxpayer’s protest is sustained to the extent that taxpayer can document that its machine shop tools and equipment are used to fabricate replacement parts for exempt machinery and equipment. Taxpayer’s protest is denied to the extent that the machine shop tools and equipment are used for the normal repair and maintenance of taxpayer’s equipment and machinery.

#### **Safety Clothing and Equipment**

Taxpayer protests the imposition of the gross retail tax on its purchase and use of safety clothing and equipment. Taxpayer believes that its purchase and use of the safety clothing and equipment is exempt from taxation because it is required either to allow workers to participate in the production process without injury, or is necessary to prevent contamination of the product during production.

Regulation 45 IAC 2.2-5-8(c) Ex.2(F) states:

(2) The following types of equipment constitute essential and integral parts of the integrated production process and are, therefore, exempt.

(F) Safety clothing or equipment which is required to allow a worker to participate in the production process without injury or to prevent contamination of the product during production.

Items that are required by state or federal environmental regulations are automatically exempt. Absent any governmental mandates, the test remains whether the clothing and equipment are required to allow the employees to safely participate in the production process or are essential and integral to taxpayer’s integrated production process.

In this instance, taxpayer has not shown how the uniform rentals are required for employees to safely participate in the production process, or how the clothing and equipment are essential and integral to taxpayer’s production process. However, pending further information, the safety equipment (boots, jackets, and respirators), work belts, “ earmuffs,” and backbrace may qualify for exempt status.

#### **FINDING**

Taxpayer’s protest is denied regarding the assessment of use tax on its uniform rentals. Taxpayer’s protest is sustained to the extent that it can be shown that the items listed in taxpayer’s protest (Appendix I, Item H) are either essential and integral to the production process or are required for its employees to participate in taxpayer’s production process.

#### **Compliance with Environmental Quality Control Standards**

Taxpayer believes that its expenses to ensure compliance with state and local environmental standards should be exempt from Indiana retail sales and use tax. Taxpayer has incurred expenses to comply with state and local air pollution standards. Taxpayer refers to the Opacity Regulations of 326 IAC 5, which state in part:

(2)(B) Visible emissions from a facility located in [taxpayer’s] [c]ounty shall not exceed an average of twenty percent (20%) opacity in twenty-four (24) consecutive readings unless otherwise specified in 326 IAC 6-1-10.1.

Taxpayer has been cited for noncompliance - specifically for vehicular traffic emissions from traffic on unpaved roadways and surfaces. In response, taxpayer has undertaken two measures. To keep vehicular traffic emissions at compliance level, taxpayer has utilized a dust suppressant system consisting of a water truck, and the chemical calcium chloride. Taxpayer has also paved portions of its internal dirt roadways with asphalt.

IC 6-2.5-5-30 states:

Sales of tangible personal property are exempt from the state gross retail tax if:

- (1) the property constitutes, is incorporated into, or is consumed in the operation of, a device, facility, or structure predominantly used and acquired for the purpose of complying with any state, local, or federal environmental quality statutes, regulations, or standards; and
- (2) the person acquiring the property is engaged in the business of manufacturing, processing, refining, mining, or agriculture.

Consumed, in this context, “means the dissipation or expenditure by combustion, use or application. See 45 IAC 2.2-5-70.

The water truck qualifies for exemption as a device that is “predominantly used and acquired” to comply with state and local environmental regulations. Calcium chloride, on the other hand, does not qualify for the exemption because it is neither incorporated into nor consumed in the operation of an exempted device – i.e., the water truck. While calcium chloride is sprayed on the ground to form a barrier, it is not dissipated, used up.

Taxpayer's hoped for objective of decreasing visible emissions could not be accomplished if the calcium chloride was "consumed," as defined in 45 IAC 2.2-5-70.

The asphalt paving and other items associated with the paving of the roadways also are not exempt from sales and use tax. The asphalt is not incorporated into a device, facility, or structure that is *predominantly used and acquired for the purpose of complying with any state, local, or federal environmental standards*. The asphalt is placed on top of a roadway. The roadway's predominate purpose is to afford a pathway for various vehicles to travel.

#### **FINDING**

Taxpayer's protest is sustained to the extent that the water truck qualifies for exemption. Regarding taxpayer's protest of the assessment of calcium chloride and asphalt paving materials and equipment, taxpayer's protest is denied.

#### **Items Erroneously Assessed Twice**

Taxpayer protests the assessment of certain items twice.

Taxpayer contends that "the Auditor's [w]orkpapers indicate a careless review of the facts which resulted in a proposed tax assessment that is arbitrary and excessive." Taxpayer argues that the Department "carelessly assessed numerous capital items twice." Taxpayer requests that the Department "revise its assessment to exclude the erroneous double taxation of specific transactions.

The Department and the taxpayer agree that the six (6) items identified in Appendix II, Item (J) in taxpayer's brief represent items mistakenly counted twice during the audit.

#### **FINDING**

Taxpayer's protest is sustained for these six items.

### **III. Tax Administration — Interest and Penalty**

#### **DISCUSSION**

The taxpayer protests the imposition of interest and the ten percent (10%) negligence penalty.

Interest is required by statute and may not be waived. See IC 6-8.1-10-1(e).

The negligence penalty imposed under IC 6-8.1-10-2.1(e) may be waived by the Department where reasonable cause for the deficiency has been shown by the taxpayer. Specifically:

The department shall waive the negligence penalty imposed under IC 6-8.1-10-2.1 if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section. 45 IAC 15-11-2(e).

While taxpayer has prevailed on many issues, records show that taxpayer has self-assessed use tax on few items over the three year audit period. Taxpayer has also subtracted sales tax from invoices for items that are obviously taxable – such as office furniture. The facts indicate that taxpayer may lack institutional controls to monitor its compliance with the Indiana sales and use tax statutes. The Department, therefore, concludes that taxpayer has not made a reasonable effort to comply with Indiana law.

#### **FINDING**

The taxpayer's protest is denied.